FILE COPY

NOV 17 1941

CHARLES ELMORE CROPLEY
CLERK

Supreme Court of the United States

OCTOBER TERM 1941

No. 137

PRUDENCE REALIZATION CORPORATION,
Petitioner,

vs.

JOSEPH W. FERRIS, GEORGE L. LONG and HENRY LEFIERT as Trustees under a Declaration of Trust dated as of July 1st, 1938, with respect to 307 West 36th Street (Burnside) First Mortgage Participation Certificates, CITY BANK FARMERS TRUST COMPANY and MARTIN S. LINDGROVE as Trustees under the Last Will and Testament of Herman Stutzer, deceased, on behalf of themselves and other holders of certificates in 307 West 36th Street (Burnside) First Mortgage Participation Certificates, SOLOMON ZAUDERER, MILTON KIMMELMAN, IRVING ZAUDERER and CHARLES KIMMELMAN, doing business as KIMMELMAN AND ZAUDERER, on behalf of themselves and all other holders of Prudence Bonds Corporation participating certificate issue, and HUNTER L. DELATOUR, RAYMOND REISLER and JEROME THRALLS, Trustees of Realty Associates Securities Corporation, Debtor, holders of Burnside Certificates.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF NEW YORK, COUNTY OF NEW YORK.

BRIEF ON BEHALF OF PETITIONER, PRUDENCE REALIZATION CORPORATION

IRVING L. SCHANZER,
JAMES F. DEALY,
Counsel for Prudence Realization Corporation, petitioner.

PAGE

Geist v. Prudence Realization Corporation, 122 F. (2d) 503 8

Local Loan Co. v. Hunt, 292 U. S. 234 ..... 18, 19, 20

Moore v. Bay, 284 U. S. 4 28

Pink v. Thomas, 282 N. Y. 10 24

In re The Prudence Company, Inc., 90 F. (2d) 587 7

Kelly v. Middlesex Title Guarantee and Trust Company, 115 N. J. Eq. 592, aff'd on this opinion 116 N. J. Eq. 574 29

Matter of Title & Mortgage Guaranty Co., 275 N. Y. 347 24

Prudence Realization Corporation v. Geist, 316 U. S. 89 ..... 3, 8, 9, 10, 11, 12, 14, 16, 17, 27, 28

Sampsell v. Imperial Paper & Color Corporation, 313 U. S. 215 28

Sola Electric Co. v. Jefferson Electric Co., 317 U. S. 173 26

Ward v. Love County, 253 U. S. 17 26

In re Westover, 82 F. (2d) 177 ..... 4, 31

Wragg v. Federal Land Bank of New Orleans, 317 U. S. 325 26

TEXTS

55 Harv. L. Rev. 283, 285 (1941) 29

40 Mich. L. Rev. 739, 740 (1942) 29

41 Yale L. J. 315, 318 (1941) 29

Supreme Court of the United States

OCTOBER TERM 1944

No. 137

PRUDENCE REALIZATION CORPORATION,
Petitioner,

vs.

JOSEPH W. FERRIS, GEORGE L. LONG and HENRY LEFIERT as Trustees under a Declaration of Trust dated as of July 1st, 1938, with respect to 307 West 36th Street (Burnside) First Mortgage Participation Certificates, CITY BANK FARMERS TRUST COMPANY and MARTIN S. LINDGROVE as Trustees under the Last Will and Testament of Herman Stutzer, deceased, on behalf of themselves and other holders of certificates in 307 West 36th Street (Burnside) First Mortgage Participation Certificates, SOLOMON ZAUDERER, MILTON KIMMELMAN, IRVING ZAUDERER and CHARLES KIMMELMAN, doing business as KIMMELMAN AND ZAUDERER, on behalf of themselves and all other holders of Prudence Bonds Corporation participating certificate issue, and HUNTER L. DELATOUR, RAYMOND REISLER and JEROME THRALLS, Trustees of Realty Associates Securities Corporation, Debtor, holders of Burnside Certificates.

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF NEW YORK, COUNTY OF NEW YORK.

BRIEF ON BEHALF OF PETITIONER, PRUDENCE REALIZATION CORPORATION

Opinions Below

Written opinions have been rendered by the Additional Special Term Justice (R. 221, not reported), by the Ap-

pellate Division, First Department of the Supreme Court of the State of New York, County of New York (R. 231, reported at 266 App. Div. 543), and by the New York Court of Appeals (R. 241, reported at 292 N. Y. 210).

Jurisdiction

The judgment and order of the New York Court of Appeals was entered on March 10, 1944 (R. 234), and the judgment of the Supreme Court, New York County, was entered thereon on April 20, 1944 (R. 238). The jurisdiction of this Court is invoked under Section 237(b) of the Judicial Code, as amended (28 U. S. C. A., Sec. 344(b)).

Questions Presented

The New York Court of Appeals held its own decisions controlling on the question of creditor participation in an insolvent estate which had been reorganized under Section 77B of the Bankruptcy Act. The property reorganized was real estate and a mortgage thereon, against which participation certificates had been issued. The 77-B trustees of the insolvent guarantor held some of the certificates. Solely to avoid delay in consummating the 77-B Plan for the Certificate Issue, it was amended so as to provide that no distribution should be made thereunder upon such certificates until an adjudication was had by a "court of competent jurisdiction" of the rights to participation with respect to such certificates. The plan as so amended was confirmed and the reorganization proceeding closed. Thereafter, an action was instituted in the New York State courts wherein the plaintiffs prayed for adjudication of the rights of participation to which the certificates held by the insolvent guarantor were entitled. Petitioner is the creditors' corporation organized pursuant to the plan of reorganization of the bankrupt guarantor and succeeded to its rights.

Named as a defendant, it demanded judgment decreeing that it was entitled to parity of treatment with other certificate holders on the ground that since the certificate issue and the guarantor had been reorganized under Section 77B of the Bankruptcy Act and the question of participation on account of its certificates had been reserved in the manner and circumstances above described, such question was determinable in accordance with federal law and that under applicable federal decisions its certificates were entitled to parity of treatment with those held by others. The Appellate Division of the New York Supreme Court unanimously upheld petitioner's view and ordered judgment in its favor on the authority of *Prudence Realization Corporation* v. *Geist*, 316 U. S. 89 (R. 233). The Court of Appeals reversed, holding that the question of parity was one of state law and that under local law petitioner's certificates are subordinate to other certificates (R. 241). The principal questions involved are:

1. Did the state court litigation necessarily involve adjudication of substantial title, rights, privileges or immunities specially set up or claimed by petitioner under the Constitution or statutes of the United States?

2. In construing the provisions of a Plan adopted in a reorganization proceeding under Section 77B of the Bankruptcy Act, was the state court correct in failing to give effect to the provisions of the Bankruptcy Act and the decisions of this court thereunder?

3. Was the state court correct in disregarding the effect of bankruptcy reorganization proceedings for the certificate issue and the guarantor and in applying local law alone in determining the rights of the guarantor's creditors to participate in the proceeds of the certificate issue?

4. Was the state court correct in construing a provision in a federal plan of reorganization not alone as a grant of concurrent jurisdiction to a state court, but as a surrender of creditors' rights under the Bankruptcy Act as well?

Statement

The Prudence Company, Inc., hereafter called "Prudence" was organized under the Banking Law of the State of New York in 1919. It was engaged in the business of making loans secured by mortgages on real estate. The bonds and mortgages received for such loans were assigned to an affiliated corporation, Prudence-Bonds Corporation. In many instances, Prudence-Bonds Corporation transferred these bonds and mortgages to corporate trust companies called depositaries and issued certificates of participation in such mortgages to Prudence which in turn sold them to the general public together with its guaranty of payment of principal and interest. The guaranty of Prudence called for the payment of interest on the certificates when due and for the payment of principal within eighteen months after maturity (R. 36). These mortgage participation certificates constituted the holders tenants in common of the underlying bond and mortgage (*In re Westover* [C. C. A. 2d], 82 F. [2d] 177).

As part of its business, from time to time Prudence either repurchased some of these certificates from the investing public or received them in exchange for certificates in other mortgages.

Prudence Realization Corporation, the petitioner here, was organized pursuant to a plan of reorganization for Prudence under Section 77B of the Bankruptcy Act (R. 16). The plan was proposed by Reconstruction Finance Corporation, the largest single creditor of Prudence, after a finding had been made that Prudence was insolvent. The plan provides that the stockholders of Prudence have no interest in the liquidation of its assets and provides for the distribution of the proceeds of such liquidation to creditors only (R. 16). Petitioner is therefore a creditors' realization corporation and in no way represents interests of the old stockholders.

The Burnside Certificate Issue was created in the general manner above described. The mortgage originally in the principal sum of $1,200,000 was reduced by payment to $1,016,000. The certificates to the extent of $1,016,000 are presently outstanding (R. 14). Included in the assets of the insolvent Prudence estate transferred to petitioner are $431,212.86 in principal amount of Burnside certificates which were repurchased in the regular course of its business by Prudence during 1932 and 1933 (R. 15, 40). These certificates were included in the corporate assets of Prudence as evidenced by published financial statements and corporate balance sheets prepared by certified public accountants (R. 142).

In January, 1935, an involuntary petition for the reorganization of Prudence under Section 77B of the Bankruptcy Act was filed in the Eastern District Court and on February 1, 1935, the petition, consolidated with the debtor's voluntary petition for reorganization, was approved and trustees appointed. An order was entered in that proceeding prescribing the procedure for the filing of proofs of claim by creditors including certificate holders of the Burnside Certificate Issue who were unsecured creditors of the debtor. In these proofs of claim certificate holders asserted unsecured claims for the full principal and interest due on the Prudence guaranty of the certificates held by them (R. 133, 138) and they were allowed as such.

On March 16, 1936, pursuant to authorization secured in the Prudence proceeding, the petition for reorganization of Amalgamated Properties, Inc., a subsidiary of Prudence, was approved by the Eastern District Court (R. 14). Included among its assets was the real property subject to the Burnside Certificate Issue mortgage, and in that proceeding a plan of reorganization for that issue was proposed which provided for the transfer of the real property by Amalgamated to three trustees appointed for certificate holders who also, pursuant to said plan, ac-

quired the certificated mortgage. The lien of the mortgage was preserved for the benefit of all the certificate holders who also became co-owners of the real estate. That plan of reorganization for the Burnside Issue, as amended, was finally approved by the District Court on June 14, 1938 (R. 15), and the property together with the outstanding mortgage was transferred to Joseph W. Ferris, George L. Long and Henry Lefiert, trustees, respondents herein (R. 174).

The plan of reorganization for the Burnside Issue did not distinguish between rights of the Prudence trustees and other holders of certificates to participate in the proceeds of the trust estate. A question, however, arose as to the right of the Prudence trustees to share on a parity with other holders of certificates, in view of the fact that Prudence had guaranteed the payment of principal and interest of the certificate issue. In order to avoid delay in the consummation of the plan, the plan was amended by agreement so as to provide that no distributions should be made thereunder on the Prudence-held certificates until the rights of such certificates were adjudicated by "a court of competent jurisdiction" (R. 16). This amendment to the plan was approved by the judge in charge of the proceeding in his order confirming the plan (R. 129). The order approving the amendments and confirming the plan did not separately classify the Prudence trustees (R. 112, 113).

The plan of reorganization for Prudence was confirmed by the District Judge in charge of that proceeding and of the proceeding for the reorganization of the Burnside Certificate Issue on May 26, 1939, ten months after the Burnside plan had been approved (R. 87). In accordance with its provisions, all of the assets of Prudence and its trustees were transferred and assigned to petitioner, the creditors' realization corporation, by assignment dated June 1, 1939. As is set forth in the order confirming the Prudence plan, there were outstanding obligations of Prudence aggregating $133,713,000 (R. 46). Of these claims only the

claim of the United States of America for $400,000 has been fully paid.

Prior to the institution of the proceeding for the reorganization of Prudence and in June, 1932, all of the stock of its wholly owned subsidiary, Amalgamated Properties, Inc., had been deposited as part of the collateral for a loan made by Reconstruction Finance Corporation to Prudence. In 1938, in accordance with the decision of the Circuit Court of Appeals for the Second Circuit (*In re The Prudence Company, Inc.*, 90 F. [2d] 587), the ownership of that subsidiary of Prudence passed from the bankrupt estate to Reconstruction Finance Corporation. During 1940, as a result of negotiations between Reconstruction Finance Corporation and petitioner, a claim of petitioner against Amalgamated was assigned to a subsidiary of Reconstruction Finance Corporation in exchange for certain assets of Amalgamated. Upon the consummation of this compromise Reconstruction Finance Corporation's subsidiary became the sole creditor and stockholder of Amalgamated and sought the dismissal of the reorganization proceedings relating to Amalgamated since no reorganization was necessary. In order to accomplish such a dismissal it was necessary to close the proceedings for the reorganization of the several certificate issues which had been reorganized in the Amalgamated proceeding, including the Burnside Certificate Issue. For that reason, and that alone, an order was entered closing the Burnside Certificate Issue reorganization proceeding (R. 134).

In May, 1940, the trustee appointed as a result of a plan of reorganization for the Zo-Gale Certificate Issue, which also had been reorganized in the Amalgamated proceeding, started a proceeding in the federal court in the Amalgamated proceeding to determine the parity question which had been reserved in the Zo-Gale plan for adjudication by "a court of competent jurisdiction". That application had not yet been determined by the District Court.

Under these circumstances the order dismissing the Amalgamated proceeding specifically reserved jurisdiction in the federal court with respect to the pending motion for the determination of the parity question in the Zo-Gale Issue (R. 135).

The District Court's opinion in the *Zo-Gale* case was rendered on January 25, 1941, holding that the Prudence-held certificates were subordinated. The court there held that the law of the State of New York was controlling on the issue and that under such decision other holders of certificates were entitled to priority in the distribution of the proceeds of the Zo-Gale estate.

In August, 1941, the United States Circuit Court of Appeals for the Second Circuit affirmed by a divided court the decision of the District Judge in the *Zo-Gale* case (*Geist* v. *Prudence Realization Corporation*, 122 F. [2d] 503). This Court on January 5, 1942, granted a petition for a writ of certiorari to the United States Circuit Court of Appeals in the *Zo-Gale* case, and on April 28, 1942, rendered its decision unanimously reversing the decision of the Circuit Court of Appeals in the *Zo-Gale* case, and held that the question of parity was one of federal law and that under the Bankruptcy Act petitioner, as representative of the creditors of the insolvent guarantor, was entitled to a position of parity with all other certificate holders (*Prudence Realization Corporation* v. *Geist*, 316 U. S. 89).

Immediately after the District Court decision was rendered in the *Zo-Gale* case, and on February 25 and 26, 1941, complaints were served upon petitioner by the trustees-respondents and by holders of Burnside certificates suing in a respresentative capacity, in actions for declaratory judgments instituted in the Supreme Court of the State of New York, County of New York, by which actions the plaintiffs sought to secure a determination that the certificates held by petitioner in the Burnside Certificate Issue were subordinated to certificates held by others. Answers were filed by other certificate holders

seeking equivalent relief by cross-complaint against petitioner. Answers were interposed by petitioner which denied that the certificates held by it were to be subordinated and, further, urged as affirmative defenses that in view of the reorganization of the certificate issue and the guarantor in the federal court under the provisions of the Bankruptcy Act, the question of participation in the distributions of the proceeds of the Burnside Certificate Issue was a question of federal law as to which the provisions of the Bankruptcy Act and the federal decisions thereunder were controlling (R. 182). The actions were thereafter consolidated.

After this Court's decision in the *Geist* case, petitioner moved in the Additional Special Term of the Supreme Court of New York County for summary judgment (R. 8). No issues of fact were presented and all parties agreed that the matter could be disposed of as a matter of law, the primary question being whether this Court's decision in *Prudence Realization Corporation* v. *Geist, supra,* was controlling, or whether the issue was determinable solely as a matter of New York law (R. 221). As part of the record a deposition was taken of a witness called by respondents (R. 142, 220). The Justice at Additional Special Term denied the motion for summary judgment (R. 221). Appeals were taken from the order entered upon that decision by all the interested parties and the Appellate Division of the Supreme Court of the State of New York, First Department, unanimously reversed the Special Term and held that where the certificate issue and the guarantor are reorganized in the federal court, the question of participation in the assets of the insolvent certificate issue is one of federal law and that under the decision of this Court in *Prudence Realization Corporation* v. *Geist, supra,* the certificates held by petitioner are entitled to parity with all other certificate holders (*Ferris et al.* v. *Prudence Realization Corporation*, 266 App. Div. 543 (R. 232).

Appeals were taken from the judgment entered upon that decision by the trustees-respondents and by City Bank Farmers Trust Company and Martin S. Lindgrove, etc., certificate holders. The New York Court of Appeals reversed the Appellate Division. It determined that since the question of parity had been reserved for determination by a "court of competent jurisdiction," and the federal court had not determined the issue in the reorganization proceeding, the question was left for determination by the New York court exclusively as a matter of local law. Upon that basis the New York Court of Appeals purported to distinguish this Court's opinion in *Prudence Realization Corporation* v. *Geist*, omitting, however, reference to the fact that the question of parity in that case similarly had been reserved for adjudication by "a court of competent jurisdiction" (R. 241).

Specification of Errors

The New York Court of Appeals erred

1. in holding that the certificates of participation in the Burnside Certificate Issue owned by Prudence Realization Corporation are not entitled to parity of distribution with certificates held by others but are subordinate to such certificates;

2. in holding that the question of parity was determinable as a matter of New York law;

3. in failing to hold that since the Burnside Certificate Issue and The Prudence Company, Inc., the guarantor, were reorganized in the federal court under Section 77B of the Bankruptcy Act, the question of parity was determinable as a matter of federal law;

4. in failing to hold that, in accordance with the provisions of the Bankruptcy Act and the decision of this Court in *Prudence Realization Corporation* v. *Geist*, 316 U. S.

89, Prudence Realization Corporation is entitled to share equally with other certificate holders in the proceeds of the Burnside Certificate Issue;

5. in holding that the plan of reorganization for the Burnside Certificate Issue contained no provision with reference to Burnside Certificate Issue certificates held by petitioner.

Summary of Argument

POINT I—THE STATUS OF PETITIONER'S CERTIFICATES IS DETERMINABLE UNDER FEDERAL LAW.

POINT II—THE NEW YORK RULE IS A LOCAL RULE NOT BINDING ON THE FEDERAL COURT.

POINT III—UPON EQUITABLE GROUNDS PETITIONER'S CERTIFICATES ARE ENTITLED TO PARITY.

POINT IV—THE JUDGMENT ENTERED ON THE DECISION OF THE NEW YORK COURT OF APPEALS IS ERRONEOUS AND SHOULD BE REVERSED.

POINT I

The status of petitioner's certificates is determinable under federal law.

In *Prudence Realization Corporation* v. *Geist*, 316 U. S. 89, this Court held that petitioner's certificates in a certificate issue similar to the one here involved, and similarly reorganized, were on a parity with certificates held by others. In the order confirming the plan of reorganization in that case, the question of parity had been reserved for adjudication by a "court of competent jurisdiction". The controversy was submitted to the federal court by a motion,

made by the trustee appointed in the order confirming the plan of reorganization, for an order subordinating this petitioner's certificates.

In concluding that petitioner's certificates were entitled to a parity status, this Court treated the question as one involving the determination of petitioner's claim in the bankruptcy proceeding. *Prudence Realization Corporation* v. *Geist*, *supra*, at page 97. As bases upon which the allowance or rejection of such a claim should be determined, the Court referred to the Bankruptcy Act requirements of equality of distribution and that a plan of reorganization shall be fair and equitable. The Court further noted that the plan contemplated by the Bankruptcy Act shall "not discriminate unfairly in favor of any class of creditors" (Ibid, at p. 93).

In emphasizing that the question was one for determination in accordance with the Bankruptcy Act, the Court disposed of the argument advanced that the New York law was determinative of the participating rights of creditors in the proceeds of a bankrupt's estate and said at page 95:

> "The bankruptcy act prescribes its own criteria for distribution to creditors. In the interpretation and application of federal statutes, federal not local law applies. See *Awotin* v. *Atlas Exchange Bank*, 295 U. S. 209; *Chesapeake & Ohio Ry.* v. *Martin*, 283 U. S. 209, 212-213; *Board of Comm'rs* v. *United States*, 308 U. S. 343, 349-350; *Deitrick* v. *Greaney*, 309 U. S. 190, 200; *Royal Indemnity Co.* v. *United States*, 313 U. S. 289, 296. The court of bankruptcy is a court of equity to which the judicial administration of the bankrupt's estate is committed, *Securities and Exchange Commission* v. *U. S. Realty Co.*, 310 U. S. 434, 455-457, and it is for that court—not without appropriate regard for rights acquired under rules of state law—to define and apply federal law in determining the extent to which the inequitable conduct of a claimant in acquiring or asserting his claim in bankruptcy requires its subordination to other claims which, in other respects, are of the same class. Cf. *Taylor* v. *Standard Gas Co.*, *supra*; *Pepper* v. *Litton*, *supra*."

The nature of the guaranty obligation and the fact of the guarantor's bankruptcy were considered as elements determining whether on equitable grounds the bankruptcy court would have been justified in subordinating petitioner's certificates under the Bankruptcy Act.

Nothing contained in the opinion indicated that the reservation of the parity question for future determination meant anything other than that the determination of petitioner's claim was being postponed. This Court did not treat such postponement as constituting any diminution in the rights of the claimant to secure a determination in accordance with the Bankruptcy Act, nor as any waiver of the right to secure such a determination. On the contrary, the language of the opinion clearly indicates that the issue involved was determinable exclusively in accordance with the provisions of the Bankruptcy Act.

In determining that petitioner's certificates were entitled to parity, this Court gave effect to the bankruptcy of the guarantor in deciding that there was no equitable justification for a subordination decree which would grant preference to one group of the guarantor's creditors at the expense of the remaining creditors holding similar guaranty claims. At page 97 this Court said:

> "The Prudence Company is not solvent. Its property is being liquidated in bankruptcy where all the claimants on its present and other guaranty obligations are entitled to share equally in its unpledged assets. Denial of the right to prove its claim, which is an asset in which all of Prudence's creditors are otherwise entitled to share, will serve only to divert this asset from all creditors to one class of creditors, the Zo-Gale certificate holders, and thus give to them the exclusive benefit of a security for which they have not bargained. Allowance of the Prudence Company's claim does not involve any breach of its duty as guarantor. Nor does it deprive certificate holders of their right to share in this asset *pari passu* with the other creditors, or of any right, legal or equitable, to which they are entitled by virtue of their position as guaranteed

creditors. See *Hampton* v. *Phipps*, *supra*; *Prairie State Bank* v. *United States*, 164 U. S. 227; *Henningsen* v. *United States Fidelity & Guaranty Co.*, 208 U. S. 404."

The conclusion that there was no equitable basis for subordinating petitioner's certificates in the *Geist* case was based upon this Court's analysis of the Bankruptcy Act and the rights of creditors of the bankrupt guarantor as established by that statute. The determination was not based upon the choice of the federal forum for the ultimate litigation of the status of petitioner's claim, but on the fact that the guarantor and the certificate issue had been reorganized in the federal court under the Bankruptcy Act, and that the status of petitioner's claim must be determined in accordance with the Act, regardless of where or when the issue was ultimately litigated.

In the present case, the New York Court of Appeals has disregarded the true import of the *Geist* case. It has interpreted the reservation of the parity question for adjudication by a "court of competent jurisdiction" as a license to ignore the bankruptcy of the guarantor and the Section 77B reorganizations of the guarantor and the certificate issue. This conclusion is contained in the following excerpt from its opinion:

> "Upon this record it appears without contradiction that the Burnside plan of reorganization did not attempt to define or determine the relative rights of Realization Corporation as the holder of certificates acquired by Prudence and of other holders of Burnside certificates, nor was any determination of these rights made in the Bankruptcy Court in the course of its administration or in connection with the distribution of any of the assets either of Prudence or of Amalgamated. The controversy, therefore, was brought to the State courts, as contemplated by the plan of reorganization, for determination of these relative rights unaffected by the reorganization consummated in the Federal court.

"Corporate reorganization in the Federal courts is a process of adjustment and modification of legal rights frequently involving the impairment of contractual obligations under plans predicated upon the consent of security holders and creditors and upon the court's approval of the plan as fair and equitable and therefore binding upon the minority. If neither the plan nor any order in the proceeding undertakes to modify the legal rights but leaves those rights to be determined by courts of competent jurisdiction, such courts have no power to impair the legal or equitable rights of the parties. The court below erroneously regarded the *Geist* case as establishing a rule. It was only effective in determining a question affecting the administration and distribution of assets in the particular reorganization before the court. To conclude that our decision is ruled by the decision of the Supreme Court in the *Geist* case, we should have to modify the Burnside plan of reorganization, which did not undertake to determine, define or modify the relative rights of certificate holders under the Burnside mortgage." (*Ferris* v. *Prudence Realization Corporation*, 292 N. Y. 210, at pp. 218, 219.) (R. 245, 246).

The Court of Appeals not alone disregarded the basis of the *Geist* case, but some of the relevant facts in the present case as well. In the first place, the relative rights of petitioner and other holders were specifically modified by the plan. The plan provided that if the Prudence certificates were not entitled to parity, then the income which would have been payable on the certificates should be distributed one-half to other certificate holders and one-half to the sinking fund for the purchase of certificates. The "court of competent jurisdiction" was required merely to determine whether the Prudence certificates were or were not entitled to parity. It could not determine that question unaffected by the reorganization and exclusively as a state law question, because the provision in the plan for the disposition of the income, if subordination was decreed, was on a basis wholly inconsistent with state law. Thus, it could not have been contemplated

by the plan, as held by the Court of Appeals, that the controversy should go to the state court for determination unaffected by the reorganization. On the contrary, no matter what the forum was, it was necessary to interpret the rights of the parties under the plan of reorganization in bankruptcy. Such a question necessarily could not be unaffected by the reorganization proceeding.

Secondly, even if the plan itself did not specifically provide for the distribution of the fund dependent upon whether or not the Prudence certificates were entitled to parity, there would still remain the question of the effect the bankruptcy had on what otherwise would have been the rights of the parties.

As indicated, the interpretation of the reservation language was before this Court in the *Geist* case. There, as here, the creditors' realization corporation was the petitioner. Respondent was, as here, the trustee appointed in the order confirming the certificate issue plan of reorganization. The language of reservation was substantially identical with that in the instant case:

Prudence Realization Corporation v. Geist, supra Case on Appeal (R. 6)	Ferris v. Prudence Realization Corporation (R. 243, 244)
"Some question has arisen with respect to the rights of The Prudence Company, Inc. on account of $816.67 of Certificates held or claimed by that Company and its Trustees, and question has also arisen with respect to the interest in said Mortgage (being the $7,200 principal amount thereof not represented by outstanding Certificates) owned or claimed by The Prudence Company, Inc. and its Trustees and/or by Prudence-Bonds Corporation and its Trustees."	"A question has arisen with respect to the rights of The Prudence Company, Inc., or its Trustees on account of the certificates held or claimed by them, including so-called 'unissued certificates.'"

Prudence Realization Corporation v. Geist, supra Case on Appeal (R. 6)	Ferris v. Prudence Realization Corporation (R. 243, 244)
Anything in the Amended Plan the contrary notwithstanding, e Trustee under the Amended an shall make no distributions cash and/or securities on ac- unt of the Certificates now ld or claimed by The Prudence mpany, Inc. and its Trustees, on account of the part of said ortgage which is not repre- nted by outstanding Certifi- tes, *unless and until it shall ve been finally adjudicated by court of competent jurisdiction* at The Prudence Company, Inc. d its Trustees and/or Pru- nce-Bonds Corporation and its ustees are entitled to share in e trust estate by reason there- ." (Italics supplied.)	"Anything in the Plan to the contrary notwithstanding, the Trustees to be appointed hereunder shall make no distributions of cash or other property or securities which would be otherwise distributable on account of the certificates now held or claimed by The Prudence Company, Inc., or its Trustees, including said 'unissued certificates,' *unless and until it shall have been finally adjudicated by a Court of competent jurisdiction* whether or not The Prudence Company, Inc. or its Trustees, or their successors or assigns, are entitled to receive such cash or other property or securities and to share in the proceeds of the property to be assigned to the Trustee pursuant to the Plan and on a parity with other certificate holders or otherwise." (Italics supplied.)

In each case the litigation to determine the parity question was instituted after the consummation of the plans, and sought the same relief.

The only factual variations in the two cases are that in the *Geist* case the trustee of the reorganized certificate issue selected the federal forum as the most expedient, and in the present case the respondent trustees, holding a similar position, selected the state court as the forum for determination, and that in the *Geist* case the proceeding was instituted prior to the closing of case and in the present case the action was instituted after such closing.

Unless these factual variations are sound bases for distinction between the two cases, it would appear that the

conclusion of the Court of Appeals that the plan contemplated that the parity question be determined as a matter of state law directly contradicts the decision in the *Geist* case.

The reservation of the question for determination by "a court of competent jurisdiction" having been inserted in the plan for the purpose of avoiding delay in consummation could mean only what the phrase could mean any time, namely, that the question be reserved for adjudication at a later time in a suit between the same parties instituted in any court having personal jurisdiction over such parties. Such grant of concurrent jurisdiction to such a court does not constitute an agreement by the parties that their status shall be altered or amended, and that such succeeding litigation should be unaffected by intervening bankruptcy.

This Court in *Local Loan Co.* v. *Hunt*, 292 U. S. 234, discussed the question of concurrent jurisdiction in connection with the competency of a state court to determine whether an assignee of future wages could sue in the state court against the employer of a debtor who had received a discharge in bankruptcy. There the Illinois state court had previously held that it would refuse to give effect to the discharge in bankruptcy and would permit the action to proceed to judgment. An injunction was sought in the federal court restraining the continuation of the state court action not because the state court lacked power to adjudicate the question, but because the prior state court decisions indicated that it would here render a judgment which would be "destructive of the purpose and spirit of the bankruptcy act". This Court sustained the injunction. In considering the competency of the state court's jurisdiction this Court said at page 241:

> "So far as appears, the municipal court was competent to deal with the case. * * * And it may be conceded that the municipal court was authorized in the law action to afford relief the equivalent of that which respondent now seeks in equity."

In the present case nothing in prior decisions by the New York Court had indicated that it would refuse to give effect to a federal decision interpreting the rights of a bankrupt's creditors between themselves. No ground for injunction, therefore, was available to petitioner here upon the institution of the state court action. In the present case, as was true in *Local Loan Co.* v. *Hunt, supra,* the state court was competent to determine the controversy submitted to it. However, the competency of the court did not free it of the obligation to apply the proper federal law to the determination of the controversy.

Particularly is this true in the present case, where it must be conceded that the litigation of the parity question could have proceeded at the instance of either the petitioner or the respondents in either the federal or the state courts and either before or after the closing of the case. The plan does not define a "court of competent jurisdiction", nor specify the time when the determination should be made. Moreover, the plan provides that the trustees respondents shall account annually to a court identified in the plan as the New York Supreme Court (R. 98). It is clear that had the parties intended that the "court of competent jurisdiction" be the same state court, the language would have been similarly specific.

The other ground upon which the *Geist* case might be distinguished is the fact that in the present suit the proceeding was instituted after the closing of the reorganization proceeding for the certificate issue. Since the proceeding could have been instituted prior to the closing of the case, the delay in institution should not affect the rights as they existed at the date when the action could have been started. No statute of limitations or other procedural device fixing time is involved here, but merely the determination of substantive rights. Particular emphasis cannot be placed upon the closing of the Amalgamated proceeding since the closing of any case in bankruptcy reorganization

is effected solely for the benefit of the debtor. The closing order contains the bar order freeing the debtor from claims against it. The creditors are affected only to the extent that they are enjoined from prosecution of any actions against the debtor. The plan having been consummated, the property having been transferred and new securities issued, the creditor has no further claim against the debtor and the closing order is a pro forma order entered disposing of the case.

The same procedural steps relating to the consummation of the plan, the transfer of the property, the issuance of the new or amended securities were effected in the *Geist* case and in the present case. As appears from the record here, the closing order was required by the debtor corporation for its own purposes (R. 134).

It is clear that the procedure adopted by the debtor *after* the reservation could not adversely affect the rights of petitioner as they existed at the time of the reservation. The parity question remained determinable as it would have been had there been no closing order entered prior to its determination. The closing order in a reorganization proceeding is the counterpart of a discharge in bankruptcy. Rights fixed by bankruptcy are not lost by the discharge, nor may the parties proceed without regard to it. In *Local Loan Co.* v. *Hunt*, *supra*, the bankrupt had been discharged, but the Court granted injunctive relief to protect the bankrupt against the state court's usurpation of federal prerogative.

The identity in relevant facts disposes of the purported distinction between the *Geist* case and the present one. The basic issue is the one presented and decided in the *Geist* case: whether, under Bankruptcy Act rules of distribution, petitioner's certificates are entitled to parity.

POINT II

The New York rule is a local rule not binding on the federal court.

In the *Geist* case, this Court analyzed the New York rule and stated that in the absence of an actual agreement to subordinate the guarantor, it is merely a general rule of law governing insolvency proceedings, and is not controlling in bankruptcy. *Prudence Realization Corporation* v. *Geist*, *supra*, at p. 97. This Court made its own analysis of the certificate to determine the existence or non-existence of an agreement to subordinate, and did not rely upon that offered by the Court of Appeals in that court's persistent policy of subordination.

In opposing the granting of the petition for a writ of certiorari here, respondents contended, and probably will again contend, that the New York rule is a substantive rule of intent and therefore binding on this Court.

An examination of the opinion in this case, however, negatives these contentions. Confronted with this Court's analysis of the New York rule in the *Geist* case, *supra*, the New York court merely reiterated its prior statements contained in decisions referred to in the *Geist* case. Although in an apparent effort to take this case outside the scope of the *Geist* decision the court stated that this was not a proceeding in bankruptcy or a state liquidation proceeding, the court repeated that the rule subordinating a guarantor is operative where there are "insufficient proceeds of the debt". (*Ferris* v. *Prudence Realization Corporation*, 292 N. Y. 210, 222) (R. 249, 250).

The New York court here affirmatively recognized that the federal plan or bankruptcy court order could determine the parity question as one of federal law, but held that since, in its view, no such determination had been made, and the parties by inserting the reservation in the plan had agreed that the parity question should be determined in accordance with state law, the basis for decision was

therefore the state rather than the federal law (*Ferris v. Prudence Realization Corporation, supra*, at p. 218) (R. 246).

On the question of alleged "actual intent", the documents contained in the record and discussed by the New York Court of Appeals refute the conclusion that in this case there was actually an agreement by the guarantor to subordinate its certificates.

The certificates provide:

> "The share or part in said bond, mortgage and extension agreement represented by this certificate, is not and shall not be subordinate to any other share or shares thereof, and is not and shall not be subject to any prior interest therein" (R. 32);

and further:

> "The Corporation, The Guarantor and The Bank of America, New York, for their respective corporate accounts, may be the holder or pledgee of similar shares in said bond and mortgage, as extended" (R. 34).

They further provide:

> "1. The Corporation and/or The Prudence Company, Inc., hereinafter called the 'Guarantor,' are irrevocably authorized to collect all moneys payable under the terms of said mortgage; credit said bond, mortgage and extension agreement with payments thereon and in its own name to satisfy or assign said mortgage upon payment thereof; account to the holder of this certificate for his share of the principal and for interest at the rate of 5½% per annum thereon, payable under the terms of this certificate and to retain any balance of moneys collected;" (R. 33).

The New York Court of Appeals relied upon the last quotation for its conclusion to subordinate the guarantor's certificates (*Ferris* v. *Prudence Realization Corporation*, 292 N. Y. 210, 222, 223) (R. 249-251). In reaching that conclusion it ignored the fact that the "controlling" paragraph does not deal with ownership or rights in the certificates

and that it provides merely for a servicing agency and for the compensation to be received by the guarantor, not in its capacity as guarantor, but as such agent. It is to be noted that the paragraph is a grant of authority not alone to the guarantor but to the "Corporation and/or the Guarantor", and that the language of retention of excess is used in connection with the obligation of either the corporation or the guarantor, not to pay principal or interest in connection with any guaranty, but to "account" for moneys collected as such agent (R. 33). To urge that such agency agreement, contained in the same document which provides clearly for ownership by the guarantor of certificates which shall not be subordinate to any other shares, constitutes evidence of actual intent to subordinate, is to contradict the plain intent of the English language.

Further, it would appear clear that any alleged ambiguity which might exist as to the contractual right of the guarantor to parity is dissipated by the affirmative provision that the guarantor, for its corporate account, may be the holder or pledgee of similar shares in the bond and mortgage (R. 34). If the certificate is considered as providing for subordination, then this provision is meaningless. Surely the guarantor could hold subordinated certificates without contractual approval. It contradicts any normal reading to conclude that such a provision authorizing the holding of similar certificates, not alone as owner but as pledgee as well, does not clearly provide for parity, and it contradicts common sense to assert that the guarantor would provide that if it accepted such certificates as a pledge for a loan, and took title upon default, then the certificates so acquired would be subordinated.

Even the New York court recognizes that the language in this certificate does not constitute "actual intent", for as that court here stated:

> "Here, as in the other cases, there are clauses which, standing alone, might be taken to indicate parity of treatment as between the guarantor and the other

certificate holders. This was true in *Matter of Title & Mortgage Guaranty Co.* (*supra*) and in *Matter of People* (*Union Guar. & Mtg. Co., supra*). When there is ambiguity in the agreement relied upon by the guarantor in support of a claim of parity, the rule denying parity to the guarantor is enforced." (*Ferris* v. *Prudence Realization Corporation, supra*, at p. 223) (R. 250, 251).

The rule referred to, denying parity to the insolvent guarantor, is the same rule considered by this Court in the *Geist* case. In the New York court, where a guarantor-creditor relationship exists, the court will presume an intention by the guarantor to subordinate its interests, retained or reacquired, to the interests of its assignees where the proceeds of the securities are insufficient. *Matter of Title & Mortgage Guaranty Co.*, 275 N. Y. 347, 352. Such presumption is rebuttable only by language in the certificates which must be "so clear and unmistakable that the courts would be compelled to give effect to the intent of the parties as expressed in the writing. Otherwise the equitable rule should prevail." (*Pink* v. *Thomas*, 282 N. Y. 10, 12.)

It seems clear that the rule is one of presumed intent, and that the guarantor, in seeking to rebut the presumption, is limited to the language of the certificate, which must be "so clear and unmistakable" as to compel the court to carry out such intent. No proof as to actual intent to provide for parity is deemed pertinent. And the presumption rests solely on the court's own view as to an equitable result. In substance, therefore, the court has established its own rule of distribution and has fixed the strict limits within which its own rule may be overcome. It then proceeds to "interpret" the language of what it has designated as the sole pertinent document. If, by its characterization of such a rule as being based upon a contract and its "black-is-white" construction of clear language, it could bind the bankruptcy court to the state's method of insolvency distribution, uniformity in bankruptcy administration and distribution would be destroyed.

A situation similar in principle to the one here presented was decided by this Court in *American Railway Express Company* v. *Levee*, 263 U. S. 19. Respondent had instituted an action in the Louisiana court to recover the value of a lost trunk. The railroad had relied on the limitation of liability in accordance with the regulations of the Interstate Commerce Commission. The Louisiana code provided that the burden was on the carrier to show that the loss was occasioned by accidental and uncontrollable events. This Court granted a petition for a writ of certiorari to the Court of Appeal of Louisiana, and in reversing the judgment in favor of the plaintiff Mr. Justice Holmes said at page 21:

> "Coming to the merits, the limitation of liability was valid, whatever may be the law of the State in cases within its control. *Adams Express Co.* v. *Croninger*, 226 U. S. 491. *Union Pacific R. R. Co.* v. *Burke*, 255 U. S. 317, 321. *American Ry. Express Co.* v. *Lindenburg*, 260 U. S. 584. The effect of the stipulation could not have been escaped by suing in trover and laying the failure to deliver as a conversion if that had been done. *Georgia, Florida & Alabama Ry. Co.* v. *Blish Milling Co.*, 241 U. S. 190, 197. No more can it be escaped by a state law or decision that a failure to deliver shall establish a conversion unless explained. The law of the United States cannot be evaded by the forms of local practice. *Rogers* v. *Alabama*, 192 U. S. 226, 230."

The presumption of a conversion, based upon the failure to deliver unless explained within the narrow limits prescribed by the code, is analogous to the presumption of intent to subordinate established by the New York court in the parity cases and the limitation upon the proof admissible in rebuttal. It is submitted that Mr. Justice Holmes' opinion in the above case similarly is here applicable.

Where a federal right is involved, this Court has examined the facts and the conclusions of a state court and reversed where it believed that the federal right was denied by the interposition of a non-federal ground of

decision having no fair support. *Creswill* v. *Knights of Pythias*, 225 U. S. 246; *Ward* v. *Love County*, 253 U. S. 17; *Davis* v. *Wechsler*, 263 U. S. 22; *Ancient Egyptian Order of Nobles of the Mystic Shrine* v. *Michaux*, 279 U. S. 737.

This Court's power to analyze the local rule to determine its true basis has been reaffirmed on many occasions. Recently, in determining whether a right of redemption was a property right subject to the jurisdiction of the bankruptcy court as against a claim that under Alabama law it was a personal rather than a property right, this Court said:

> "But §75 prescribes its own criteria for determining what property interests may be brought within the jurisdiction of the court. In the interpretation and application of the Bankruptcy Act as in the case of other federal statutes, federal not local law applies. *Prudence Realization Corp.* v. *Geist*, 316 U. S. 89, 95, and cases cited. It is for the bankruptcy court to determine, by reference to the provisions of the bankruptcy statute, what rights created by state law—regardless of the characterization which may be applied to them by state statutes and decisions—are within the jurisdiction of the bankruptcy court. *United States* v. *Pelzer*, 312 U. S. 399, 402, 403."
>
> (*Wragg* v. *Federal Land Bank of New Orleans*, 317 U. S. 325, at p. 328.)

In *Sola Electric Co.* v. *Jefferson Electric Co.*, 317 U. S. 173, the question was whether a patent licensee was estopped to challenge a price-fixing clause in the licensing agreement by showing that the patent was invalid. The case came to the federal court because of diversity of citizenship. The Circuit Court sustained the defense, without indicating whether it was applying the state or federal estoppel rule. This Court, in reversing, said at pages 175 and 176:

> "For here a different question is presented—whether the doctrine of estoppel as invoked below is so in

conflict with the Sherman Act's prohibition of price-fixing that this Court may resolve the question even though its conclusion be contrary to that of a state court.

"It is familiar doctrine that the prohibition of a federal statute may not be set at naught or its benefits denied, by state statutes or state common law rules. In such a case our decision is not controlled by *Erie Railroad* v. *Tompkins*, 304 U. S. 64. There we followed state law because it was the law to be applied in the federal courts. But the doctrine of that case is inapplicable to those areas of judicial decision within which the policy of the law is so dominated by the sweep of federal statutes that legal relations which they affect must be deemed governed by federal law having its source in those statutes, rather than by local law. *Royal Indemnity Co.* v. *United States*, 313 U. S. 289, 296; *Prudence Realization Corp.* v. *Geist*, 316 U. S. 89, 95; *Board of Com'rs of Jackson County* v. *United States*, 308 U. S. 343, 349, 350; Cf. *O'Brien* v. *Western Union Telegraph Co.*, 1 Cir., 113 F. 2d 539, 541. When a federal statute condemns an act as unlawful the extent and nature of the legal consequences of the condemnation, though left by the statute to judicial determination, are nevertheless federal questions, the answers to which are to be derived from the statute and the federal policy which it has adopted. To the federal statute and policy, conflicting state law and policy must yield. Constitution, Art. VI, cl. 2; *Anotin* v. *Atlas Exchange Nat. Bank*, 295 U. S. 209; *Deitrick* v *Greaney*, 309 U. S. 190, 200, 201."

However, even the Court of Appeals has not made the claim that its rule is binding on the federal bankruptcy court. Its application of its own rule to the instant case came only after it had decided that by agreement of the parties the issue was reserved to it "unaffected by the reorganization consummated in the Federal court" (*Ferris* v. *Prudence Realization Corporation, supra*, at p. 218) (R. 246). If, as submitted by petitioner, the court was in error in so concluding, the ultimate decision here comes within the *Geist* case, and this Court will apply its own rule of distribution in bankruptcy.

POINT III

Upon equitable grounds petitioner's certificates are entitled to parity.

Beyond the mere assertion that the rule is an equitable one, neither the New York court nor respondents have justified subordination of an insolvent guarantor's certificates on equitable grounds. Equality in distribution is an integral part of bankruptcy administration. *Prudence Realization Corporation* v. *Geist*, *supra*; *Moore* v. *Bay*, 284 U. S. 4. The burden rests on those seeking subordination to show that the failure to grant them preference will work an injustice. *Sampsell* v. *Imperial Paper & Color Corporation*, 313 U. S. 215, 219.

In the present case petitioner is the guaranty creditors' realization corporation. Respondent certificate holders are guaranty creditors holding claims against the insolvent guarantor, sharing in the proceeds of the liquidation of the guarantor's estate together with all the other guaranty creditors. Petitioner submits here, as it did in the *Geist* case, *supra*, that the subordination of its certificates will prefer these creditors as against the remaining creditors, without justification or purpose.

In the *Geist* case, *supra*, this Court said at page 97:

> "The Prudence Company is not solvent. Its property is being liquidated in bankruptcy where all the claimants on its present and other guaranty obligations are entitled to share equally in its unpledged assets. Denial of the right to prove its claim, which is an asset in which all of Prudence's creditors are otherwise entitled to share, will serve only to divert this asset from all creditors to one class of creditors, the Zo-Gale certificate holders, and thus give to them the exclusive benefit of a security for which they have not bargained."

This Court there was referring to the bankruptcy of Prudence and the rights of its creditors *inter sese*. Unless

some action on the part of the remaining creditors caused damage to the Burnside guaranty holders, or the action of Prudence in repurchasing the certificates conferred a benefit exclusively on the remaining creditors or effected a hardship upon the Burnside guaranty holders, it would appear that not alone would parity not work an injustice upon respondents, but that subordination would grant an unwarranted and inequitable preference in their favor.

The stipulation entered into by the parties contains all the operative facts. The record here, including the deposition taken at the instance of respondents from their witness, shows that the certificates were acquired in the usual course of business by Prudence (R. 146, 169, 170); that the reacquired certificates were listed on Prudence's balance sheet as assets (R. 142); that in 1932 Prudence was faced with substantial maturities and applied for and received a loan of $20,000,000 from Reconstruction Finance Corporation (R. 154).

From the foregoing data respondents argue that Prudence was insolvent or imminently insolvent at the time of its acquisition of the certificates, that the reacquisition was to reduce its guaranty obligations and, apparently in an effort to come within some of the language in the *Geist* case, *supra*, at p. 96, respondents assert that such acquisition was an incident to Prudence's guaranty.

Nothing said thus far, however, relates to the rights of the guaranty creditors *inter sese*. Nor do the facts nor even the inferences indicate any inequitable conduct by the guarantor for the benefit of the remaining creditors at the expense of the Burnside guaranty holders. On the contrary, respondents' position is no more than an outright request for an unjustifiable preference. *Kelly* v. *Middlesex Title Guarantee and Trust Company*, 115 N. J. Eq. 592, aff'd on this opinion 116 N. J. Eq. 574; (1941) 55 Harv. L. Rev. 283, 285; (1941) 41 Yale L. J. 315, 318; (1942) 40 Mich. L. Rev. 739, 740.

If the actual or imminent insolvency of Prudence at the time of reacquisition is assumed, then certainly at that time its assets were held ratably for the benefit of all of its creditors. Prior to the acquisition of these certificates, Burnside creditors were entitled to no preference as against the remaining creditors. If Prudence then purchased some Burnside certificates with cash or other assets belonging to all creditors, the result of a parity determination will be solely to substitute the purchased certificates for the cash or other assets originally used to purchase them. Such substitution will result in the distribution of the proceeds of the certificates in the same manner as would have been invoked had there been no repurchase.

A subordination decree, however, changes the method of distribution by giving to the remaining Burnside guaranty creditors the benefit of all of the proceeds of the certificates, leaving the remaining creditors not alone without their pro rata portion of the original cash or assets used for the repurchase, but penalizes them by depriving them of their pro rata share of the proceeds of the substituted certificates.

If Prudence, through its brokerage account purchases, paid less than par, then the selling certificate holder was adversely affected, and all remaining creditors benefited. If Prudence paid par and this was more than the worth of the certificates, then the selling certificate holder was benefited and all the remaining creditors damaged. No matter what form the analysis takes, it is evident that the remaining Burnside certificate holders suffered no harm separate from the other creditors, and that such other creditors received no benefit not shared by these Burnside certificate holders.

As to the repurchase as an incident of Prudence's guaranty, the facts belie the argument. Prudence was under no obligation to pay principal for 18 months beyond the maturity of the certificates. Notice of the invocation of the so-called 18-months clause was given to the creditors

(R. 157). Under these circumstances, its practice in 1932 in attempting to secure reinvestment by its customers was consistent with its usual business policy of keeping customers, of doing business (R. 170).

An examination of this Court's opinion in the *Geist* case will demonstrate that the reference to the acquisition of securities as an incident of its guaranty was made by this Court in connection with the surety cases cited by the Court at page 96 of its opinion. In the present case, as was true in the *Geist* case, the rights claimed by petitioner in the certificated mortgage are not asserted by way of subrogation. The relationship between the guarantor here and certificate holders was not the customary suretyship relationship. The making of the mortgage loan was independent of the guaranty, which was given, not at the instance of the borrower, but by the guarantor after the making of the loan. Nor were the certificates or the mortgage here collateral security for the guaranty obligation. The certificates represented an undivided share in the mortgage and upon their acquisition by Prudence, Prudence became the holder of an interest in a mortgage. That was the precise question raised and determined in *In re The Westover, Inc.* (C. C. A. [2d] 1936), 82 F. (2d) 177. As the record discloses, such interests constituted a substantial portion of its assets, were its sale inventory, and were sold by the guarantor for profit. The manner of acquisition of certificates through a brokerage account at substantial discount was necessarily consistent with the purpose of the company in acquiring mortgage interests at less than par for future sale at a profit, and had the guarantor resold the specific certificates here involved, its purchaser would clearly have been entitled to parity.

It is submitted, however, that the discussion of the solvent surety cases by this Court in the *Geist* case and the reference to the acquisition of certificates by the guarantor as independent of its guaranty, were an incident of this Court's analysis of the equitable rules of distribution

of a bankrupt's assets. Respondents seek, not the protection of such rules, but their avoidance. Not alone have they failed to sustain the burden of showing that the refusal to grant the requested preference would work an injustice upon this single group of guaranty creditors, but they have demonstrated that subordination of the interests of the remaining guaranty creditors would violate the basic, equitable rule of pro rata distribution of an insolvent estate among creditors of the same class.

POINT IV

The judgment entered on the decision of the New York Court of Appeals is erroneous and should be reversed.

Respectfully submitted,

IRVING L. SCHANZER,
JAMES F. DEALY,
Counsel for Prudence Realization Corporation, petitioner.